



CHAPTER 7

Formalizing the Contract

Upon determination of the apparent successful contractor, the next step is to prepare a written contract identifying all terms of agreement between the contracting parties.

7.1 Contract Negotiations

Prior to awarding a personal service contract, the agency determines if it is advisable to conduct negotiations. Negotiations may be held with the apparent successful contractor if more favorable contract terms are desired or if the proposal is not sufficiently precise or direct. Areas in the proposal that may be considered less than satisfactory include: time devoted to the project or phases of the project by the consultant, scheduling, certain items of scope, billing items, etc. Negotiations should eliminate any ambiguities in the contractor's proposal and clarify contract terms. If the terms offered in the initial proposal are considered fair and equitable, an award may be made without negotiation.

The agency's primary consideration during contract negotiations is to reach a mutually advantageous position on issues of concern while fulfilling administrative and technical requirements. The recommended approach in negotiations is not to acquire an unfair advantage or to make unreasonable demands of the consultant, but to secure the most favorable terms and conditions for the agency.

Negotiated solutions are effective when each party has a stake in maintaining the conclusion. Throughout the process the negotiator must establish and continue sound, cooperative and respectful relationships with the other party. Inquisitive, exploratory, purposeful, yet diplomatic, probing can produce the knowledge required to make informed business decisions in negotiations.

7.2 Draft Contract

Personal service contracts must always be set forth in writing. The required elements for a personal service contract are: identification of the parties; scope of service; maximum compensation and payment mechanism; period of performance; and signatures of responsible parties. Numerous other terms are included in contract documents to provide additional legal protection to the State. Agencies may utilize a contract format appropriate to the services being acquired. For example, an agency may use a “short form” contract when the contract is less than \$5,000 and/or for a simple scope of services.

The formal written contract is to accurately document all terms and conditions and record the intent and agreement of the parties. The contract is the culmination of the entire procurement process and formalizes the agreement between the parties. Agency personal service contracts generally have two primary sections: 1) General Terms and Conditions and, 2) Special Terms and Conditions.

The agency’s contract format is to be reviewed "as to form" by the Attorney General's Office (AGO) prior to execution. As long as the AGO-approved contract format is used, it is not necessary that each contract executed by the agency be approved "as to form" by the Attorney General's Office.

Agencies will not structure contracts to avoid the competitive procurement or other requirements of this policy.

7.3 General Terms and Conditions

The General Terms and Conditions are contract terms established by law. These terms have been determined by the Attorney General's Office to apply to most agency personal service contracts. The General Terms and Conditions are not to be changed without specific advance approval by the Attorney General's Office. They are generally attached as the first exhibit to the contract.

7.4 Special Terms and Conditions

The Special Terms and Conditions are the terms governing a specific contract and include the elements indicated below. Many other terms may be routinely included in an agency's Special Terms and Conditions. For the purposes of this manual, only the most common elements are included.

7.4.1 Identification of the Parties

This section identifies the parties entering into the contract. It states the name of the agency, the contractor's legal corporate name and address, and may include other identifying information such as telephone number, fax number, e-mail address, state Unified Business Identifier number (issued by the Department of Revenue), and either the Taxpayer (Federal) Identification Number or Social Security Number of the contractor.

7.4.2 Scope of Work

The scope of work is the single most important element in the contract. This section documents all elements of the work and magnitude of the project and reflects the mutual understanding of the parties. The scope of work is to be consistent with the project and services described in the solicitation document issued. It is important to remember ambiguous provisions are generally interpreted against the drafting party.

Hold the contractor accountable: The contract should hold the contractor accountable for results. Results or performance should be the focus, not procedure or process. Work requirements should be written in an auditable, results-oriented manner and clearly define all performance objectives, work expectations and project milestones. Results may include reports, training sessions, assessments, evaluations or other tangible services.

Be precise: The more precision in the scope of work, the more likely the contractor will satisfy the agency's need. Performance requirements should be written in such a way that it can easily be determined if and when the contractor has successfully completed performance. An auditable, results-oriented scope of work should also include

consequences for noncompliance, such as non-payment or termination of the contract.

Use active voice: The clearest way to indicate who is responsible for the work is to use the active voice. Precede requirements with "The Contractor will or must" or "The Agency will or must." Use of the passive voice obscures who is responsible.

Due dates: Due dates for formal written reports or other deliverables are to be stated in the contract as well as any timelines for required oral progress reports. Also include contract monitoring requirements. For example, regular meetings should be scheduled to review standards, evaluate progress, identify problem areas, and to determine actions to be taken by parties to resolve problems. Contractor's staff assignments should also be included in the scope, as applicable. This ensures that personnel shown in the proposal are assigned to the contract with the time commitments reflected in the proposal. It also allows the agency to effectively lock in time commitments of key consultant personnel.

An option is to incorporate the contractor's proposal. The scope of work section of the contract may also simply incorporate the contractors' proposal by reference, if all work objectives are satisfactorily defined. When incorporating the contractor's proposal it is important that it remains accurate and that no changes have been negotiated after the proposal was submitted.

7.4.3 Period of Performance

The contract is to specify a start date and a completion date. While there may be exceptions, in most circumstances, an end date will be required.

Personal service contracts, subject to filing with OFM, should include appropriate language to reference the effective start date. For certain competitive contract filings, work may begin the date the contract is filed with OFM. For others, the contract effective date will be ten (10) working days after the date filed with OFM, subject to the review and/or approval of OFM. For contracts and amendments subject to the 10 working day filing period, the following language is helpful to include in the documents:

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Under the provisions of Chapter 39.29 RCW, this personal service contract/amendment is required to be filed with the Office of Financial Management (OFM). No contract required to be filed is effective and no work thereunder shall be commenced nor payment made therefore until ten (10) working days following the date of filing, and if required, until approved by OFM. In the event OFM fails to approve the contract, the contract shall be null and void.

Personal service contracts may cross biennial and fiscal year lines, and, when they do, the contract should specify that any service performed beyond the end of the fiscal year or biennium is authorized contingent upon receipt of funding. No services are to be provided until funding is authorized.

7.4.4 Compensation and Payment

This section must include all elements relating to cost and payment, such as maximum contract cost, cost per deliverable, rates for individuals providing services, number of hours required, allowable expenses and total authorized for expenses, payment, and invoicing procedures. Clearly defining cost elements authorized for reimbursement will avoid confusion or minimize disputes later in the contract.

With few exceptions, agencies may not pay for any service prior to receipt thereof, per the Washington State Constitution, Article VIII, Section 5, "Credit Not to be Loaned."

This section should also include whether the agency will pay expenses incurred by the contractor and, if so, which ones. Such expenses may include airfare (economy or coach class), lodging and subsistence necessary during periods of required travel; expenses incurred during travel for telephone, copying and postage, and private vehicle mileage. If other types of expenses are to be allowed, they must be clearly defined. Travel expenses for contractors are generally reimbursed at the current state travel reimbursement rates, which are posted on the following OFM website: <http://www.ofm.wa.gov/policy/10.10.htm>.

The contract should state the maximum dollar amount allowed to be paid under the contract for expenses. To

determine the contract threshold for OFM filing, the total dollar amount of the contract, including the amount to be paid for services plus the estimated amount to be paid under the contract for expenses, is used.

It is also helpful to include invoicing instructions in the contract. The agency may require use of State Form A-19, Invoice Voucher, for submittal of requests for payment. The contract should state how often invoices should be submitted and require that the invoice include sufficient detail and supporting documentation to determine the appropriateness of the charges. Many contracts require that any single expense in the amount of \$50 or more should be accompanied by a receipt in order to receive reimbursement.

7.4.5 Fiscal Reporting

Fiscal reporting provisions require a contractor to report on or allow access to financial information at defined intervals during the contract, or upon contract completion or termination. The purpose of financial reporting provisions is to aid in monitoring contractor performance and/or fiscal accountability, and to allow contract managers to make informed decisions about the contractor's ability to perform or meet contract requirements.

Key considerations for fiscal reporting provisions are:

- Define the type of information and documentation required.
- Specify dates or intervals for reports, if any.
- Require access to contractor staff, records, and place of business, as appropriate.
- Require intensive financial record monitoring if appropriate to the method of compensation.

7.4.6 Payment Documentation

The contract should define the information and documentation required to justify payment.

At a minimum, payment documentation should include contract number, date(s) service was provided, description of services provided or any goods received, and approval for payment. The approval for payment can be documented by the initials of the approving staff and date on the contractor's

invoice, or by an electronic approval process. For further information, refer to Section 85.32.30 of the State Administrative and Accounting Manual, published by the Office of Financial Management, at <http://www.ofm.wa.gov/policy/85.32.htm>.

Financial record retention and access should follow state agency requirements and should be identified in the contract. The Office of the Secretary of State publishes the General Records Retention Schedule for Agencies of Washington State Government at <http://www.secstate.wa.gov/gs/default.htm>.

7.4.7 Signatures of Responsible Parties

Only those persons with authority to bind the parties may sign the contract document. The agency representative who signs a contract should have delegated signature authority. The contract is considered executed when all authorized parties have affixed their signature.

It is good business practice to have the contractor sign the document first. This ensures that the contractor has reached full agreement and the agency can respond with its approval signature.

The signature block should not appear on a page by itself. A portion of the text of the contract should be included at the top of the page.

State agencies, colleges, universities and institutions use a variety of contract formats for their personal service contracting. Each agency is required to have its contract format approved “as to form” by the Attorney General's Office. An example of an approved personal service contract appears as Appendix E.

7.5 Explanation of Other Contract Terms and Conditions

A brief explanation of terms and conditions typically used by state agencies as part of either their Special or General Terms and Conditions follows. This listing is not all-inclusive of the contract terms used by all state agencies. However, it does capture those elements that most frequently apply to agency personal service contracts.

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Advance Payments Prohibited – All payments must be made after the delivery of service. Agencies cannot issue payment for services prior to the performance of work.

Changes and Modifications – This sets out the terms for equitable adjustment if changes are made to the contract that impact cost, period of performance or services to be provided.

Confidentiality – Contractor is required to maintain all information about the agency and information accessed under the contract as confidential. Contractor cannot use, disclose, share, transfer or sell to third parties any information accessed under the contract that may be classified as confidential.

Conflict of Interest – The agency may, by written notice, terminate the right of the contractor to proceed if the agency finds that any gratuity, bribe, extra payment in the form of entertainment, gifts or otherwise has been offered or given by the contractor with the intent of securing the contract or receiving favorable treatment with regard to any aspect of the contract.

Contract Representatives – The contract should identify by name or by position the persons responsible for representing the agency and the contractor as contract managers in matters related to the execution of the contract. These individuals will be accountable for project performance and results.

Covenant Against Contingent Fees – The contractor warrants that no person or selling agent has been employed or retained to solicit, secure or influence award of the contract. The purpose of this prohibition is to prevent the attempted or actual exercise of improper influence of a third party in the procurement process.

Disputes – When a dispute arises between the agency and contractor, remedy may be provided through a disputes hearing or a disputes panel. The dispute process will generally precede any court action.

Funding Withdrawn – In the event funding is withdrawn, reduced or limited after the effective date of the contract, but prior to completion, the agency may terminate the contract

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under the "Termination for Convenience" clause without the required notice.

Governing Law – The contract will be governed by the laws of the state of Washington. Since commercial law varies from state to state, it is important to include the governing law, particularly when dealing with out-of-state contractors.

Indemnification – This clause protects the state from negligence or omission on the part of the other party, pursuant to RCW 4.92.270. The contractor holds the state, agency and agency employees harmless from claims, suits or actions arising from the negligence or omission of the contractor while performing the terms of the contract. Standard indemnification language is provided in the *Contracts: Transferring and Financing Risk* manual published by the Office of Financial Management, Risk Management Division.

Independent Capacity – The contract should state that the contractor is independent and neither the contractor nor contractor's employees are to be considered employees of the state. The state legitimately does not have to pay employee taxes such as workers' compensation, FICA and unemployment compensation for contractors.

Industrial Insurance Coverage – The Department of Labor and Industries administers the industrial insurance program, which provides medical coverage for workers who sustain on-the-job injuries. The contractor is required to comply with the requirements of Title 51 RCW regarding industrial insurance coverage prior to performing any contract work.

Licensing and Accreditation – Contractor agrees to comply with applicable federal, state, county or municipal standards for licensing and accreditation to assure quality of service.

Limitation of Authority – Only the individual with written delegation of signature authority may alter or modify any clause or condition of the contract.

Nonassignability – This ensures the contractor cannot sell the contract to a third party.

Noncompliance with Nondiscrimination Laws – Noncompliance or refusal to comply with the

nondiscrimination laws, regulations or policies may result in rescission, cancellation or termination of the contract.

Nondiscrimination Clause – This clause is used to ensure the contractor is in compliance with all relevant statutes and requirements relating to equal opportunity employment.

Order of Precedence – In the event of inconsistency between contract documents, the order of precedence of the documents should be stated. First, federal and state law prevails, then the special terms and conditions, the general terms and conditions, the contractor's proposal, the Request for Proposals, etc.

Privacy – Personal information collected, used or acquired under the contract is to be used only for the purposes of the contract.

Records Maintenance – Contractor will maintain books, records and documents, which reflect all direct and indirect costs expended in the performance of the contract for potential audit of billing statements, for a six-year period.

Registration with the Department of Revenue – If a contractor does not have a Uniform Business Identifier (UBI) number, the agency should notify the contractor to register with the Washington State Department of Revenue. (In some instances this is not required, and the Department of Revenue can so notify them as applicable.) When applicable, contractor will be issued a State UBI number to be used in payment of state business and occupation taxes under the contract. Out-of-state contractors performing work in Washington State are also required to have UBI numbers.

Right of Inspection – The contractor will provide right of access to its facilities to the agency or other authorized agent or official in order to monitor and evaluate performance, compliance and/or quality assurance under the contract.

Rights in Data – Data originating from the contract will be "works for hire" as defined by the U.S. Copyright Act of 1976 and will be owned by the agency.

Severability – If any provision of the contract is determined to be invalid, the other contract provisions are not automatically invalid.

Subcontracting – This section is used to define conditions under which the contractor can subcontract work. Generally, the consultant's proposal will identify the subcontractors. When the service of a subcontractor is required after award, and was not identified in the original contract, the prime contractor must request advance approval from the agency before authorizing work by the selected subcontractor on the project.

Treatment of Assets – Title to all property furnished by the agency and/or purchased by the contractor, as a reimbursable item under the contract will remain with the agency. The contractor will be responsible for loss to any such property and will return the property upon completion of the contract.

Termination for Convenience – This term allows the contract to be terminated upon advance notice when it is in the best interest of the agency.

Termination for Default – The contracting agency will reserve the right to judge the competency of the contractor at any stage of the contract. This term allows termination of the contract due to documented deficiencies in the contractor's performance.

Termination Procedure – Provides information regarding suspension of services pending approval of a contractor's corrective plan by the agency. If the corrective action plan is not accepted by the agency and the agency elects to terminate the contract, the contractor is required to deliver to the agency any property produced to the point of termination as part of the contract performance. The steps the contractor must follow once a notice of termination is received are delineated.

Third-Party Beneficiary – Any subcontracts entered into by the contractor will name the state as the third-party beneficiary.

Venue – The venue is the locality in which a trial would occur. Any lawsuit involving the contract would be filed in the county stated in this clause. For agencies in the Olympia area, for example, this is Thurston County.

Waiver of Default – This clause states that waiver of default is not to be considered waiver of any subsequent default.

7.6 Approval as to Form

“Approval as to form” by the Office of the Attorney General (AGO) verifies legality of the contract instrument, but does not imply concurrence in or approval of the content. As long as the AGO-approved format is used, it is not necessary that each contract executed by the agency be approved “as to form” by the AGO. Submittal to the Assistant Attorney General is recommended when varying from the approved contract format.

In addition to approval for form, it is often advisable to have contracts reviewed by the Assistant Attorney General for "substance and content." Some agencies submit all contracts to the Attorney General's Office for review of content; others submit only those on which there is a question as to substance or content.

7.7 Performance Bonds

When engaged in large projects or when dealing with unknown companies, it may be prudent to request that a company obtain a performance bond. A performance bond guarantees that the work will be completed in accordance with the scope of work at the original contract price. The need for a performance bond should be carefully evaluated because the cost is indirectly borne by the state. It can also discriminate against the small or new companies that cannot obtain such a bond or can only get one at a high price. Contractors who have previously defaulted or failed to complete projects may also have to pay a higher price for performance bonds.

Performance bonds are routinely required on large construction contracts to reimburse the state for any loss that may occur due to a partial or total contractor default.

7.8 Liability Insurance

The Office of Financial Management, Risk Management Division (RMD), recommends that agencies include liability insurance requirements in their contracts. At a minimum,

RMD suggests that contractors be required to purchase general liability/automobile liability and employer's liability insurance and comply with workers compensation laws. For more information on RMD's suggested insurance specifications, refer to *Contracts: Transferring and Financing Risk*. This manual is available through RMD and on the OFM web site at: <http://www.ofm.wa.gov/rmd/risk.htm>.

Contract managers should analyze the type of services to be provided and evaluate the state's exposure to legal liability that may result from contracting. State agencies can be financially protected from those who seek legal recourse by requiring personal service contractors to carry insurance. If you have questions on liability insurance, contact the Risk Management Division at (360) 902-7301. Prior to contacting RMD, contract managers should contact internal agency staff who may be knowledgeable about insurance requirements.

Appendix C, Request for Proposals, Section 2.17, includes sample language that may be used to require insurance coverage on a proposed personal service contract.

7.9 Industrial Insurance Coverage

When a state agency enters into a personal service contract, the contractor's employees should be covered by industrial insurance. This protects the state's interest, if either the contractor or someone employed by the contractor is injured while performing work under the contract.

With few exceptions, Title 51 RCW holds the contracting agency responsible for making sure the contractor has coverage. Employments excluded from mandatory coverage are listed in RCW 51.12.020 and include sole proprietors, partners, corporate officers and others. The employer may elect optional coverage for these employments.

To promote compliance with Title 51 RCW and avoid unplanned financial liability for the payment of industrial insurance premiums, agencies should review RCW 51.08.070, 51.08.180 and 51.08.195 and determine whether a potential contractor meets either the definition of "employer" or that of a "worker." Making this determination may require a complex analysis. To assist in determining whether the

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designation of “employer” or “worker” is applicable, please call the Field Audit Compliance of the Department of Labor and Industries at (360) 902-4769, (360) 902-4753 or you may contact by email at verifystatecontracts@lni.wa.gov. For security, please include (1) your full name, (2) your agency name, (3) the purpose of your request, and (4) an explanation of the attachment, if any.

For personal service contracts where the contractor meets the definition of "employer" under RCW 51.08.070, the following language should be incorporated in the contract's general terms and conditions:

Industrial Insurance Coverage – The Contractor will comply with the provisions of Title 51 RCW, Industrial Insurance. If the Contractor fails to provide industrial insurance coverage or fails to pay premiums or penalties on behalf of its employees as may be required by law, Agency may collect from the Contractor the full amount payable to the Industrial Insurance accident fund. The Agency may deduct the amount owed by the Contractor to the accident fund from the amount payable to the Contractor by Agency under this Contract, and transmit the deducted amount to the Department of Labor and Industries (L&I), Division of Insurance Services. This provision does not waive any of L&I's rights to collect from the Contractor.

In those instances where the contractor meets the definition of "worker" under RCW 51.08.180 and 51.08.195, the Department of Labor and Industries suggests the following alternative language:

The agency acknowledges that the essence of the work specified in this contract constitutes personal labor, thus making the contractor a covered "worker" as defined in Title 51 RCW. The agency therefore agrees to provide industrial insurance coverage for the contractor during the course of employment under this contract, as may be required under Title 51 RCW.

Contractors must be licensed with the Department of Labor and Industries to perform work in the construction trades. The types of work that require such licensing are described in RCW 18.27.010 and 19.28.120. Agencies can verify a contractor's compliance with Titles 18 and 19 RCW by contacting the Contractor Registration Unit at (360) 902-

5202. In the event the contractor is found to be noncompliant, the agency may still enter into the contract, but should notify the contractor that no payments for service provided under the contract will be made until the contractor furnishes evidence of full compliance. For long-term contracts, the agency should require the contractor to provide proof of continuous compliance with Titles 18 and 19 RCW prior to release of final payment under the contract.

7.10 Fiscal Considerations

Agency staff should consult with agency fiscal and auditing staff if there are questions regarding fiscal considerations of contracts. The following are general fiscal principles to be aware of:

General Fiscal Principles

- State agencies should pay no more than a reasonable and fair price for services.
- Payment to the contractor should be made according to the terms of the contract. A clear statement of work should be developed and should directly relate to the method of compensation in the contract.
- The contract should identify the source and amount of funds. If the source of funds is federal, federal rules and regulations must be followed and may supersede state rules and regulations. Consult applicable federal regulations as necessary.
- Contracts should specify that payment will **not** be made for the same or similar services more than once (no duplicate payments). Contracts should contain language to recover disallowed costs due to duplicate billing.
- Contractors should have accounting methods and systems that are describable and auditable, as applicable to the circumstances. Contractors should comply with accounting measures and principles appropriate to the contractor's type of entity and as identified in the contract.
- State agencies should use the accounting methods and systems published in the State Administrative and Accounting Manual (SAAM). You may locate the

manual

online:

www.ofm.wa.gov/policy/saamintro.htm.

- Payments made under personal service contracts should be necessary and reasonable for the type of services being provided. The costs should be directly attributable to the specific work or the normal administration of the contract.
- Payments made under personal service contracts should be adequately documented and supported by appropriate accounting records maintained by both the state agency and the contractor.
- Financial reporting procedures and requirements should be clearly identified in the contract to ensure that contractors are able to record expenses by funding source.
- State agencies should pay contractors for services in a timely manner (RCW 39.76.010).

7.11 Contract Payment Terms

Prior to the contract award, the services should be analyzed to determine the most effective compensation method (i.e., cost reimbursement, time and materials, fixed price, or performance based). Ideally, the method selected will be one that best ensures delivery of services, encourages efficiencies and effectiveness of service, and provides the best value to state agencies. In some cases, the method of compensation may include a mix of payment methods. For example, the method of compensation may be based primarily on attainment of specific performance targets, but could also include a periodic fixed or lump sum payment after completion of specific work to ensure the contractor has funding sufficient to meet core-operating requirements.

If subject to negotiation, proposed contractor budgets or rates of reimbursement should be reviewed to ensure that the level of compensation is reasonable and necessary to accomplish agency objectives. Agencies should consider whether there is a reasonable correlation between the quality of service provided and the costs of providing the service as identified by the contractor.

The method of compensation selected may have an impact on

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the level and type of monitoring activities required to ensure that the state receives the services contracted for, and where specified, the funds are used as intended. Contracts with a cost reimbursement compensation method or contracts that use multiple funding sources are likely to require a higher level of monitoring than contracts using other payment methods as they may pose a higher risk, because the costs that are reimbursed may not be eligible or necessary.

Personal service contracts should state the method of compensation that will be used to reimburse the contractor for delivery of services.

Typical methods of compensation include:

Cost reimbursement: This type of contract or method of compensation has a higher risk for the state agency because it reimburses the contractor for all costs incurred under terms of the contract. To prevent overpayment, allowable cost provisions should be clearly identified in the contract. Contract managers may want to consider including in the contract a provision for a maximum allowable compensation level for the contract period and a budget. These provisions can help to ensure the contractor is not overpaid and that only appropriate costs are reimbursed.

When the contractor will be paid on a cost reimbursement basis and will be using funding sources in addition to those provided under the state agency's contract, contract managers might want to consider requesting from the contractor a description of its methodology for assigning costs to each funding source.

Subsequent financial reports should be sufficient to track revenue and expenses by funding source. When multiple funding sources are used, it may be necessary to work with the contractor to ensure the contractor complies with the contract terms and that the appropriate documentation is maintained so that allowable costs are billed only once to the state agency. Guidance should be provided to the contractor, prior to the contract start date, for any special compliance, documentation, or other requirements that are related to the use of multiple funding sources.

Cost reimbursement contracts generally require more fiscal pre-planning and monitoring than contracts employing other

methods of compensation.

Time and materials contract: Under time and materials contracts, the state pays a fixed hourly rate and for the costs of certain specified materials. The nature of these contracts may discourage efficiencies on the part of the contractor. Time and materials contracts should have a ceiling amount that the contractor may only exceed at his/her own risk. This type of reimbursement may be used if the agency is unable to clearly define the level of effort required to accomplish the objectives. A time and materials contract places most of the risk on the agency and little on the contractor. Frequent contract monitoring is required to ensure that the number of hours is kept to a reasonable level.

Fixed price or lump sum: The contractor receives a set fixed amount or lump sum payment based on terms established in the contract. Typically, payment is tied to completion of agreed upon performance achievements. Other alternatives are possible, such as progress payments made to compensate for activities conducted over the specific period of the contract. This type of contract should generally establish a maximum allowable level of compensation. With this method of compensation, the agency does not pay if specific terms in the contract are not met and thus the risk is placed on the contractor. This allows for a more summarized form of reporting from contractor to agency.

Performance based: These contracts are based on attainment of specific outcomes. The rate of compensation is generally negotiated based on cost information provided by the contractor. In some cases, the rate may be set by agency policy or other means. Generally, performance based contracts identify the maximum allowable compensation. This allows the agency to define the quality of services in terms of performance standards and pay accordingly. Performance based contracts differ from time and materials or fixed price contracts in that if the quantifiable quality of service is low, the payment may be reduced or withheld. This requires a higher level of reporting from the contractor to the agency. The contractor primarily assumes the risk because the agency does not pay if performance levels are not met. Generally, no miscellaneous expenses are authorized under the contract. For federally funded contracts, be aware that there may be some requirements to reimburse actual costs.

The method used to determine payment to the contractor should ensure that the state receives full value for the money, and the “general fiscal principles” listed in this guide are considered. Cost settlement procedures should be established by state agencies to ensure they have a process for recovering costs that have been identified in an audit of the contractor as not allowed under the contract. Contract managers should consult with their accounting or auditing staff and with the Office of the Attorney General for further guidance.

7.12 Security for Performance

In instances where the scope of contract service is difficult to specify or define, agencies may elect to write a "security for performance" term into the contract. This allows the agency to withhold a certain percentage or specified amount from each of the contractor's invoices (often 10 percent). Upon completion of all performance obligations of the contract to the satisfaction of the agency, the withheld funds are released to the contractor.

On large construction projects, these retained funds represent considerable dollars that are held in joint escrow accounts. Upon completion and acceptance of the construction project, funds are released to the contractor.

7.13 Contract Execution

The contract is executed when all authorized parties sign it. Upon execution, signed copies of the contract should be provided to all interested parties including, but not limited to, the contractor, the contract manager, agency contract office, and agency accounting office. In most instances, service may begin immediately or may be scheduled for a predetermined date.

For those contracts subject to the 10 working day filing period, contract work may not begin prior to 10 working days from the date it is submitted to OFM, subject to OFM review and/or approval. A civil penalty may be imposed if work begins prior to the start date. See Chapter 4 for more information on filing requirements and applicable filing periods.